USAID/Montenegro

Annual Report

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Montenegro

Performance:

Background: Montenegro was a constituent republic of the Federal Republic of Yugoslavia (FRY) until March 2003, when the FRY was dissolved and it became a constituent republic of the new state union of Serbia and Montenegro. Montenegro's land area is about one-sixth that of Serbia and its population is 616,000 (less than one tenth of Serbia's), according to the preliminary results of the November 2003 population census issued by the Bureau of Statistics. The ethnic composition is considered to be predominantly Montenegrin and Serbian, with less than 25 percent Bosniak, Albanian, Croatian and Roma. Currently, there are about 31,000 refugees and internally displaced persons, mainly from Kosovo.

In October 1997, Milo Djukanovic was elected President with support from a broad multi-ethnic coalition, ousting the cronies of Slobodan Milosevic from power. Djukanovic took office in January 1998. This laid the foundation for the democratization of Montenegrin society. Social and political life became more open, NGOs and the media enjoyed greater freedoms, and the government embarked upon a series of potentially far-reaching political and economic reforms. By 2000, Montenegro had acquired a large degree of independence and established a separate economic system (it remained minimally subordinate to Yugoslavia in foreign affairs and defense matters). The United States and the European Union welcomed the government's efforts to democratize society, and provided critical financial and technical assistance for reforms.

In spite of this progress, the supportive legislative and institutional frameworks needed for moving toward a consolidated democratic system, free market and Euro-Atlantic integration are far from complete. The profound division of society over the issue of redefining or terminating the relationship between Montenegro and Serbia, years of war, and systemic deficiencies, including the legacy of the one-party rule and a socialist economy, has impeded reform. Corruption and patronage, while ostensibly being addressed, also remain significant constraints. While the government must address the task of passing legislation to address social, economic, and political problems, it must also continue to demonstrate the capacity to put laws into practice.

Long-term political stabilization and democratization in Montenegro were subjugated to an intense struggle for political power, following the March 14, 2002 Belgrade Agreement that ended prospects for Montenegrin independence, in the short-term, in favor of a loosely federated union with Serbia. The pro-independence, ruling Democratic Party of Socialist (DPS) failed to form a new government and lost control of the parliament after the Liberal Alliance (LSCG) joined Together for Yugoslavia (ZZJ). This new parliamentary majority was an unlikely alliance of the staunchest pro-independence and pro-federation groups, united only in their shared desire to turn the DPS and President Milo Djukanovic out of power. The new LSCG-ZZJ majority passed amendments fundamentally altering the election law and rules for media coverage, precipitating a crisis that nearly derailed parliamentary elections called to clarify the confused political situation.

The October 20, 2002 new parliamentary elections gave the DPS-SDP coalition an absolute majority in parliament, enabling it to form a government on its own. Ethnic Albanian parties also hold senior government positions. OSCE/ODIHR judged the elections to be generally free and fair despite a highly contentious electoral campaign and opposition accusations of bribery and pressure by the Djukanovic coalition. Djukanovic stepped down as the President of Montenegro in order to become the new Prime Minister in January 2003. Presidential elections held in December 2002 failed due to less than a 50 percent turn-out required for valid elections, as did the repeat vote in February 2003. Turn-out was hurt by voter apathy and an opposition boycott. Parliament subsequently removed the 50 percent turn-out requirement and, in May 2003, Montenegro elected for Filip Vujanovic, the previous Prime Minister, to be

President.

The opposition (largely pro-Serbian) sporadically participated in Parliamentary sessions until May 2003, when it began a boycott of parliamentary and government activities in protest of Public Television's decision, and in accordance with the media reform law, to provide only limited live TV broadcasting of the sessions as opposed to mandatory full coverage under the old law. The opposition has also seized on media reports of government complicity in cigarette smuggling and a controversial human trafficking case, and called for Djukanovic's resignation and early elections. Opposition tactics have so far had little impact on government or parliamentary activities, including adoption and passage of reform legislation. Opposition parties have begun to blame each other for their collective demise and recent local polls show that their supporters are increasingly frustrated. While the opposition parties are no longer formally trying to synchronize their activities, dialogue between the party leaders continues and they remain united in their goal of demanding Prime Minister Djukanovic's resignation and holding early parliamentary elections. DPS and SDP have publicly urged the opposition to return to Parliament, without success. The ruling parties have used the ensuing period to prepare a number of significant pieces of reform legislation, including the Parliamentary Rules of Procedure, the Law on Prosecution, the Criminal Law, the Law on Criminal Procedure and other important laws which may be passed by the end of 2003. Nevertheless, tensions between the two governing parties over the pace and character of political reform are evident. Though the ruling parties have the majority required for adjusting the Constitution of Montenegro to the Constitutional Charter of Serbia and Montenegro, which was due in August 2003, little progress has been made.

The government has taken some initial steps towards implementing the Constitutional Charter, including partial harmonization of its economy with Serbia's in order to meet the EU conditions for the Stability and Association Process. The EU continues to press Serbia and Montenegro to strengthen the state union. However, the European Parliament's recent declaration that the EU should remain neutral on the form of Serbia and Montenegro's relationship has led to speculation in Montenegro that the EU is loosening its insistence on preserving the union. Also, negotiations on implementation of the Charter with Serbia have been protracted and contentious, thus increasing skepticism about the future of the state union in both republics. While Montenegrin’s concerns about economic conditions vastly overshadow the question of state status, interest in the latter will revive closer to 2005, when Djukanovic's pro-independence coalition is likely to hold a referendum on whether to remain in the union.

In the meantime, the political crisis in Serbia (failed presidential elections, and the parliamentary elections scheduled for December 28, 2003) has raised expectations among all political parties in Montenegro that a changed political landscape in Serbia will enable each party to achieve its political goals, and may alter the relationship between Serbia and Montenegro at the union level. It is expected that the Montenegrin parliament will have a busy period in the second half of December 2003, trying to pass legislation that the Government of Montenegro (GOM) and International Community believe is important to the continuing reform process, as well as trying to agree on the replacement of several ministers who have resigned. Politicians will also be eagerly awaiting the outcome of the elections in Serbia to determine their strategies in the coming years.

Montenegro's economy was the smallest and poorest of the republics of the former Yugoslavia, characterized by the regional experience in transition from a static, centrally planned system to a decentralized market economy. To some extent the situation was mitigated by the more free-market approach of Yugoslavia, but then worsened by a decade of regional wars, sanctions, and disruption of traditional markets.

Economic policy reform initially focused on laying the basic legislative groundwork for a market economy. This was the focus of USAID's policy reform efforts, as reported in the FY 2003 Annual Report. This year has largely been focused on implementing the large body of legislation that was passed in previous years, while at the same time putting a few more key pieces of legislation into place.

The return of Milo Djukanovic as the Prime Minister led to speculation that it signaled his discontent with the current pace of reform. Soon after his taking office, USAID responded to a request from his inner circle of advisors to assist in the development of a comprehensive agenda for economic reform. This was conducted with the assistance of over 50 people from outside of government, divided into a dozen topical working groups, mapping out goals, tasks, timelines, and identifying responsible institutions and donor support across a broad range of topics. The resulting Economic Reform Agenda (ERA) was adopted by government in March 2003 and has since been the key tool used by the Prime Minister and his cabinet to drive and track economic reforms. USAID and the European Agency for Reconstruction (EAR) meet with the Prime Minster and his cabinet on a monthly basis to systematically review and discuss progress on the ERA and to develop concrete solutions to the inevitable impasses that come up in certain areas. In general, the GOM has shown good faith in its implementation.

The GOM action is needed to help ensure that economic reforms are complemented with attention to the social consequences of those reforms. Inadequate attention to social safety-net issues could negatively affect public support for reform. It is crucial that the Government enjoy wide public support for the democratic transition, which can only be ensured by a transparent reform process, and closer cooperation with civil society. However, polling data indicate that the public perception on the pace and results of reform continues to be generally negative

USAID interests and goals: The important geographical position of Montenegro in the Balkans and in Europe, along with its longstanding tenuous relationship with Serbia, has made Montenegro a primary locus for establishing stability in the region. Consequently, a stable democratic polity and growing market economy oriented toward Europe is of vital U.S. foreign policy interest.

Donor Relations: Following several years in which USAID was the primary donor in Montenegro, other donors have become increasingly important and coordination with USAID is close on several fronts. In the energy sector, in 2003 USAID handed over responsibilities to DFID for technical assistance to the Energy Regulatory Agency and to the EAR and World Bank (WB) for the completion of the unbundling exercise at the state power company, Elektroprivreda Crna Gora (EPCG). DFID has also taken on some responsibilities in the banking sector, handling the deposit insurance program and the privatization of Podgorickabanka, the last majority state owned bank in Montenegro. In pension reform, the WB is planning a loan and technical assistance to take over from USAID advisors in improving efficiencies in the pension system. USAID is also closely coordinating its efforts with the EAR customs advisors in implementation of the recently introduced value-added tax and on development and implementation of the new treasury system, as well as municipal development efforts and the upgrading of border crossing facilities. The German Development Assistance Bank (KFW) has provided a line of credit for SME lending to the Opportunity Bank, which was established in Montenegro with USAID support. With the termination of USAID budget support in FY 2003, the WB has begun its SAC and IMF assists with monetary stabilization. Under the USAID-funded private sector program one of the implementers, CIPE, has been contracted by the German GTZ to undertake a feasibility study for the development of an industrial zone. USAID also coordinated its assistance this past year with the UNDP in a high profile, successful "Farewell to Arms" campaign that resulted in increased public trust in the police forces according to a follow-up survey. USAID also continues to work closely with the OSCE and IOM on anti-trafficking initiatives. USAID made a grant to IOM to administer a shelter for victims of human trafficking and a public awareness campaign.

Challenges: Montenegro is probably more politically and economically stable than it has been in over a decade. However, this has not yet led to high levels of growth or decreases in unemployment. Much remains to be done. The recently published Poverty Reduction Strategy Paper (November 2003) reports the absolute poverty rate in Montenegro to be 12.2 percent with more than one third of the population classified as economically vulnerable. Given regional variations, this figure is 19.3 percent in the north, representing 45 percent of the total poor in the republic. GDP remains near 1990 levels (about 1.4 billion euros); unemployment once adjusted for the gray market is 17 percent; the average recorded net wage in the formal sector is about 188 Euros; inflation in 2002 was 9.4 percent; international trade, excluding Serbia, yielded a deficit of $402 million in 2002, though some of this was made up by tourism and other receipts to yield a current account deficit of $161 million; and if arrears accumulation is considered, the GOM deficit for 2002 is 39 million Euros.

Montenegro has operated for decades under a centralized party driven system, of central control that has left citizens alienated and disengaged. Maintenance and investment in local infrastructure and services have been severely neglected to a point of near collapse and serious ecological threat. Politicized intergovernmental financial flows and social services allocation has disadvantaged populations. As for the media, while the GOM adopted progressive, innovative media legislation in 2003, major challenges to the development of a truly independent media remain. While improvements have taken place, quality and unbiased news are still the exception rather than the rule. The NGO sector as a whole is not yet sustainable and FY 2003 represented a difficult transition year as donor resources, upon which it is dependent, decreased. In the political party and parliamentary arenas, Montenegro still faces a hierarchy in which political leaders, party headquarters and Parliament maintain relatively closed decision-making processes, and Parliament as an institution still lacks the ability, in general, to operate outside of character-driven politics. The judicial system, despite recently adopted progressive legislation, still remains weak and is struggling to support an effective market-driven economy that can attract foreign investment. Finally, Montenegro's history and culture as a patronage based society, and the resulting corruption that this engenders, is an issue that runs to some extent through each of these issues.

Foreign investment has been limited due to a less than attractive investment climate. Stimulating the private sector will be Montenegro's main challenge going forward. Besides its being disadvantaged by a small market with difficult access, most factors affecting development are well within Montenegro's control, but will require a considerable measure of will and difficult decision-making. Private sector development will require simultaneous progress on a number of different fronts. Now that a fairly solid set of business laws are in place, judicial reform is critical to ensuring that these laws are enforced in a fair and rapid manner, which is currently not the case. Labor markets maintain serious rigidities, with several layers of collective bargaining clouding and restricting employer rights. Infrastructure continues to be poor and badly under-financed, with government reluctant to charge cost recovery rates or enforce collections at any level. Though bank supervision has improved radically over the last few years, continued mistrust of banks leads to anemic levels of deposits and consequently limited credit available at high rates. Finally, despite vast improvements in the business registration process, rigidities and discretionary applications of regulations remain. The ability, or lack thereof, of the government to tackle these issues rests on two main pillars: social cost and political will to tackle corruption.

Key achievements: FY 2003 was a strong year for the USAID programs in Montenegro. The Mission built upon the legislative and institutional framework it helped to develop in the past and has become more constructively engaged in assisting and encouraging government in the implementation of its ambitious reform agenda. Significant implementation gains were made this past year in the financial sector, pension reform, the economic reform agenda, tax administration, local governance and community revitalization, democracy and human rights, and the rule-of-law. This effectiveness is due in large part to the respect and confidence the GOM has in USAID officials and program implementers. The continuing challenge in the coming years will be to accelerate the pace of the GOM's reform agenda while renewing people's confidence in the GOM to improve the quality of their lives.

1. Pension reform: Adoption of the new pension law will do much to bring the current "pay as you go" system into balance. Slight annual changes over time in the parameters determining pension payouts (retirement age, indexation, benefit level calculation, etc.) will help in lowering the necessary transfers from the budget and beginning to reverse the demographic trends that plague such systems globally.

2. Financial sector: This last year has been a good one for the financial sector, institutionally. The privatization of the large state bank, Montenegrobanka brought a strong foreign competitor into the banking sector. The off-shore bank issue has been effectively resolved with the cancellation of licenses by the Ministry of Finance and the closing of all correspondent accounts. The payments system is on an irreversible track to reform, with the tender of the last branch of the old monopoly payments system, and the tendering for the new inter-bank payments system. Finally, the Central Bank of Montenegro received a positive assessment according to the Basel II Core Principles of banking supervision.

3. ERA: The Government in March 2003 adopted a comprehensive economic reform agenda and has so far shown strong commitment to its implementation.

4. Value-Added Tax (VAT): The VAT began to be collected in April 2003. Initial reports are very positive with collections to date 30 percent greater than projections.

5. Local Government: Adoption of core legislation that enhances local governance, including the Law on Local Self-Government, Local Government Finance, Law on Direct Elections of Mayors and the Law on Public Administration.

6. Community Revitalization: Communities throughout Montenegro have democratically elected and operated 112 community councils and 39 cluster councils representing the majority of the Republic's population. Collectively these councils have selected, designed and carried out 356 economic and social development projects in basic infrastructure, income and employment generation, environmental protection and civic activities worth $17 million. Community contribution averaged 42 percent of total project costs, and employment generation is estimated at 4,792 person months.

7. Democracy and Human Rights: In the media sector, innovative media legislation and a broadcasting law were adopted. Transformation of State radio/TV to a public broadcaster and establishment of the Montenegro media Institute is in the planning stages. In the NGO sector, the USAID-funded Montenegro Advocacy Program has facilitated several initiatives in which NGOs successfully advocated for legislative changes at both the republic and municipal levels, including the Law on Higher Education, the Political Finance Law and the "Farewell to Arms" campaign. In the political arena, the Parliament completed the draft of the Rules of Procedure. In the area of trafficking, USAID provided support through IOM for the institutional strengthening of a shelter for victims of human trafficking and a nation-wide public awareness campaign targeting young women and minors.

8. Rule of law: The Law on Courts, which establishes the foundation for an independent judiciary as well as the establishment of two new appellate and administrative courts was adopted, along the Law on Ombudsman.

Country Close and Graduation:

Not applicable.

Results Framework

170-0130 Accelerated Development and Growth of Private Enterprise
SO Level Indicator(s):
Average Employee Salary Receipt (in Euros)
IR 170-0131 Increased Soundness of Fiscal Management
IR 170-0132 Improved Functioning of Financial Markets
IR 170-0133 Private Enteprises Strenghtened
IR 170-0134 Enhanced Economic Soundness of Energy Sector

170-0200 More Effective, Responsive and Accountable Democratic Institutions
SO Level Indicator(s):
Public Opinion Polls (Public Confidence in Institutions)
IR 170-0201 Enhanced Capacity and Competitiveness of Independent Media
IR 170-0202 Strenghtened Civil Society, Political Party and Trade Union Capacity to Serve and Represent Citizens

170-0210 Increased, Better Informed Citizens' Participation in Political and Economic Decision-Making
SO Level Indicator(s):
CRDA Communities Mobilize at Least 25% of Project Costs
IR 170-0211 Citizens Improve theri Living Conditions through Participation in Community Development Activities
IR 170-0212 Improved Local Governance Performance

170-0410 Special Initiatives
170-0420 Cross-Cutting Programs